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CFPB REDEFINES DISCRIMINATION IN FINANCIAL SERVICES WITH UPDATES TO UDAAP EXAMINATION MANUAL

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The Consumer Financial Protection Bureau (CFPB) materially altered the consumer protection landscape in the financial services industry through a series of revisions to its examination manual for unfair, deceptive and abusive acts and practices (UDAAPs) under the Dodd-Frank Act (Dodd-Frank). With deft drafting, the CFPB expanded the scope of its enforcement and supervisory authority by revising the definition of an “unfair” act or practice to include discrimination in any financial transaction involving consumer products or services. This expanded authority will enable the CFPB to reach discriminatory acts or practices well beyond the reach of traditional fair lending laws such as the Equal Credit Opportunity Act (ECOA), which is limited to the extension of credit. We summarize the CFPB’s new guidance, outline the revised examination procedures, and offer suggestions for implementation.

Discrimination as unfairness

The test for whether an act or practice is “unfair” under Dodd-Frank is well-established: (1) the act or practice causes or is likely to cause substantial injury to consumers; (2) consumers cannot reasonably avoid the injury; and (3) the injury is not outweighed by countervailing benefits to consumers or competition. In its recently enacted revisions to the examination manual for UDAAPs, the CFPB rather inconspicuously incorporated discrimination as an “unfair” act or practice by clarifying the first two elements of the test. As noted in the manual, while substantial injury is usually associated with monetary harm, the requisite injury might involve “[f]oregone monetary benefits or denial of access to products or services”, or “dignitary harms”, that result from discriminatory behavior or conduct. And while there might be instances when consumers have the means or a mechanism to avoid injury, “[c]onsumers cannot reasonably avoid discrimination” or “the harms of discrimination”. With those nuanced changes to the text of the UDAAPs examination manual, the CFPB opened new, expanded horizons in its anti-discrimination efforts and authority.

The CFPB recognized its expanded authority in the area of prohibiting discrimination in the manual’s discussion of the relationship between UDAAP and other consumer protection laws. “[A] discriminatory act or practice that is unfair, deceptive, or abusive may also violate other

antidiscrimination laws, such as ECOA.” Conversely, “[a] discriminatory act or practice is not shielded from the possibility of being unfair, deceptive or abusive even when fair lending laws do not apply to the conduct.” The CFPB cited as an example of the latter when an African-American consumer is unable to open a deposit account. Here again, without much fanfare, the CFPB effected sweeping changes in the consumer protection arena for financial services institutions with relative ease.

Examination updates

The pre-existing examination manual for UDAAP has directed examiners to obtain and review an entity’s various documentation, including written policies and procedures, and various reports, and conduct transaction testing, if further investigation is warranted.

Now, in order to identify potential discriminatory acts or practices under the expanded definition under the UDAAP, the manual directs examiners to obtain and review additional documents and information the entities may be using, such as:

- Documentation regarding the use of models, algorithms, and decision-making processes used in connection with consumer financial products and services.
- Information collected, retained or used regarding customer demographics, including the demographics of customers using various products or services, and the breakdown of consumer demographics for various product uses, fees, revenue sources and costs, or the impacts of various products and services on specific demographics.
- Any demographic research or analysis relating to marketing or advertising of consumer financial products or services.

With this additional information collected, among other things, the manual directs the examiners to determine whether the entity subject to the investigation has a process to prevent discrimination with regard to any of its financial transactions involving consumer products or services, and whether it has an appropriate and adequate compliance program. Accordingly, the examiners are directed to assess whether the

- The entity has established policies and procedures to review, test, and monitor any decision-making processes it uses for potential UDAAP concerns, including discrimination.
- The entity has established policies and procedures to mitigate potential UDAAP concerns arising from the use of its decision-making processes, including discrimination.
- The entity’s policies, procedures and practices do not target or exclude consumers from products and services, or offer different terms and conditions, in a discriminatory manner.
- The entity has appropriate training for customer service personnel to prevent discrimination.

Consistent with the added goal of identifying discriminatory acts and practices, the updated manual adds the following factors to be considered for determining potential areas for transaction testing:

- The entity improperly gives inferior terms to one customer demographic as compared to other customer demographics.
- The entity improperly offers or provides more products or services to one customer demographic as compared to other customer demographics.
- Customer service representatives improperly treat customers of certain demographics worse or provide extra assistance or exceptions to customers of certain demographics.
- The entity engages in targeted advertising or marketing in a discriminatory way.
- The entity uses decision-making processes in its eligibility determinations, underwriting, pricing, servicing or collections that result in discrimination.
- The entity fails to evaluate and make necessary adjustments and corrections to prevent discrimination.

When an examiner decides to proceed with transaction testing, the updated manual provides further examination procedures in assessing discriminatory acts or practices of an entity's marketing and disclosures, advertising, availability of credit, interaction with consumers, and servicing and collection.

Embracing the change

While this new guidance will undoubtedly drive significant changes to financial transactions in connection with consumer products and services, we anticipate some aspects will be more influential than others. Notably absent from the CFPB's new guidance is a reference to protected classes or, alternatively, a permissible basis or safe harbor for differentiating between consumers. Widely accepted distinctions in treatment among consumers may now not only invite CFPB scrutiny, but also result in supervisory or enforcement action. While the CFPB will likely apply precedent from the ECOA and related fair lending guidance when enforcing discrimination as an unfair practice, financial institutions will want to conduct risk assessments of any distinctions in the products or services provided to consumers to ensure that they are based on clear and objective criteria, taking care to reduce or eliminate discretion where possible.

The CFPB's new recognition of dignitary harms is also likely to have a resounding impact on the industry. Organizations may consider partnering with diversity, equity, inclusion, and belonging or environmental, social, and governance ("ESG") experts to further define the concept of dignitary harms within the context of their products and services. Given the inherent challenges with

detecting and remediating such harms, prevention controls will likely be the key to effective risk mitigation.

BCLP's Global Banking Sector professionals help financial institutions assess and navigate increasing regulatory scrutiny and the emerging risks attendant to the fast pace of industry change in products and services as well as enumerated regulator priorities. Please contact us if you would like more detail about our insights or if your institution needs specific assistance with financial services regulatory or litigation matters.

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